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A NEW COMPANIES ACT 2013: AN INSIGHT

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ABSTRACT

The Companies Act 1956 is an Act of the Parliament of India, enacted in 1956, which enabled companies to be formed by registration, and set out the responsibilities of companies, their directors and secretaries. The Companies Act 1956 is administered by the Government of India through the Ministry of Corporate Affairs and the Offices of Registrar of Companies, Official Liquidators, Public Trustee, Company Law Board, Director of Inspection, etc. The Registrar of Companies (ROC) handles incorporation of new companies and the administration of running companies. The Companies Act 1956 (the'1956 Act'), which had been in existence for over fifty years, appeared to be somewhat ineffective at handling some of these present day challenges of a growing industry and the interests of an increasing class of sophisticated stakeholders. The 1956 Act has been in need of a substantial revamp for quite some time now, to make it more contemporary and relevant to corporate, regulators and other stakeholders in India. The 2013 Act introduces significant changes in the provisions related to governance, e-management, compliance and enforcement, disclosure norms, auditors and mergers and acquisitions. Also, new concepts such as one-person company, small companies, dormant company, class action suits, registered valuers and corporate social responsibility have been included.

KEY WORDS: *Reporting Framework, Auditor Accountability, Restructuring, CSR & Investor Protection*

INTRODUCTION

The recently enacted Companies Act 2013 (the '2013 Act') is a landmark legislation and is likely to have far-reaching consequences on all companies operating in India. While a part of the 2013 Act has already become effective, the Draft Rules are in the midst of a consultation process. This important legislation, that has been in the making for over 10 years, started off as an effort in 2004 by the then government to make changes in Indian corporate law in the context of the changing economic, business environment, bring more accountability and to make Indian corporate environment more transparent, simple , globally acceptable and good corporate governance. The long-awaited Companies Bill 2013 got its assent in the Lok Sabha on 18 December 2012 and in the Rajya Sabha on 8 August 2013. After having obtained the assent of the President of India on 29 August 2013, it has now become the much awaited Companies Act, 2013 (2013 Act). An attempt has been made to reduce the content of the substantive portion of the related law in the Companies Act, 2013 as compared to the Companies Act, 1956 (1956 Act).The new Companies Act (hereinafter referred as CA2013) is replacing old Companies Act, 1956 (hereinafter referred as CA1956).The 2013 Act is a comprehensive form purports to deal with relevant themes such as investor protection and fraud mitigation, inclusive agenda, auditor accountability, reporting framework, director responsibility and efficient restructuring. The CA2013 makes comprehensive provisions to govern all listed and unlisted companies in the country. The CA 2013 is partially made effective w.e.f. 12th September, 2013, by way of implementing 98 Sections and repealing the relevant sections corresponded with CA1956. Some of the Salient features of the CA 2013 are as under:

1. **Democracy of Shareholders:** The CA2013 has introduced new concept of class action suits with a view of making shareholders and other stakeholders, more informed and knowledgeable about their rights.
2. **Supremacy of Shareholders:** The CA2013 focused and provide major aspect on approvals from shareholders on various significant transactions. The Government has rightly reduced the need for the companies to seek approvals to managerial remuneration and the shareholders have been vested with the power to sanction the limit.
3. **Strengthening Women Contributions through Board Room:** The CA2013 stipulates appointment of at least one woman Director on the Board of the prescribed class of Companies so as to widen the talent pool enabling big Corporates to benefit from diversified backgrounds with different viewpoints.
4. **Corporate Social Responsibility:** The CA2013 stipulates certain class of Companies to spend a certain amount of money every year on activities/initiatives reflecting Corporate Social Responsibility. There may be difficulties in implementing in the initial years but this measure would help in improving the Under-privileged & backward sections of Society and the Corporate would in fact gain in terms of their reputation and image in the Society.
5. **National Company Law Tribunal:** The CA2013 introduced National Company Law Tribunal and the National Company Law Appellate Tribunal to replace the Company Law Board and Board for Industrial and Financial Reconstruction. They would relieve the Courts of their burden while simultaneously providing specialized justice.

6. **Fast Track Mergers:** The CA2013 proposes a fast track and simplified procedure for mergers and amalgamations of certain class of companies such as holding and subsidiary, and small companies after obtaining approval of the Indian government.

7. **Cross Border Mergers:** The CA2013 permits cross border mergers, both ways; a foreign company merging with an India Company and vice versa but with prior permission of RBI.

8. **Prohibition on forward dealings and insider trading:** The CA2013 prohibits directors and key managerial personnel from purchasing call and put options of shares of the company, its holding company and its subsidiary and associate companies as if such person is reasonably expected to have access to price-sensitive information (being information which, if published, is likely to affect the price of the company's securities). Earlier these provisions were contained in regulations framed by SEBI, as the capital market regulator. Now, it has also been informed that SEBI is expected to discuss changes in certain norms for listed firms so as to make them in line with the rules in the new Act.

9. **Increase in number of Shareholders:** The CA 2013 increased the number of maximum shareholders in a private company from 50 to 200.

10. **Limit on Maximum Partners:** The maximum number of persons/partners in any association/partnership may be upto such number as may be prescribed but not exceeding one hundred. This restriction will not apply to an association or partnership, constituted by professionals like lawyer, chartered accountants, company secretaries, etc. who are governed by their special laws. Under the CA1956, there was a limit of maximum 20 persons/partners and there was no exemption granted to the professionals.

11. **One Person Company:** The CA2013 provides new form of private company, i.e., one person company is introduced that may have only one director and one shareholder. The CA1956 requires minimum two shareholders and two directors in case of a private company.

12. **Entrenchment in Articles of Association:** The CA2013 provides for entrenchment of articles of association have been introduced.

13. **Electronic Mode:** The CA2013 proposed E-Governance for various company processes like maintenance and inspection of documents in electronic form, option of keeping of books of accounts in electronic form, financial statements to be placed on company's website, etc.

14. **Restriction on Composition:** Every company shall have at least one director who has stayed in India for a total period of not less than 182 (one hundred and eighty two) days in the previous calendar year.

15. **Independent Directors:** The CA2013 provides that all listed companies should have at least one-third of the Board as independent directors. Such other class or classes of public companies as may be prescribed by the Central Government shall also be required to appoint independent directors. No independent director shall hold office for more than two consecutive terms of five years.

16. **Serving Notice of Board Meeting**: The CA2013 requires at least seven days' notice to call a board meeting. The notice may be sent by electronic means to every director at his address registered with the company. The CA1956 did not prescribe any notice period to call the board meeting of a company.
17. **Duties of Director defined**: Under the CA1956, a director had fiduciary duties towards a company. However, the CA2013 has now defined the duties of a director.
18. **Liability on Directors and Officers**: The CA2013 does not restrict an Indian company from indemnifying its directors and officers like the CA1956.
19. **Rotation of Auditors**: The CA2013 provides for rotation of auditors and audit firms in case of publicly traded companies.
20. **Auditors performing Non-Audit Services**: The CA2013 prohibits Auditors from performing non-audit services to the company where they are auditor to ensure independence and accountability of auditor.
21. **Financial Year**: Every company's financial year will be the period ending on 31 March every year.
22. **Rehabilitation and Liquidation Process**: The entire rehabilitation and liquidation process of the companies in financial crisis has been made time bound under CA2013.

The 2013 Act marks a major step forward and appreciates the current economic environment in which companies operate. It goes a long way in protecting the interests of shareholders and removes administrative burden in several areas. The 2013 Act is also more outward looking and in several areas attempts to align with international requirements. There are many areas that are the subject to rules that are to be issued under the 2013 Act. Companies may have to contemplate major changes to data and systems, education and communication to stakeholders, and changes to corporate governance. Profit profiles may be impacted, and in many cases companies would need to ramp up resourcing in certain functions. It is imperative that companies start early in understanding the key implications of these changes and plan for the change. In this article, crystallised the key changes into the following 6 critical themes, each aimed at a different stakeholder community.

1. Increased Reporting Framework
2. Higher Auditor Accountability
3. Easier Restructuring
4. Wider Director and Management Responsibility
5. Inclusive CSR Agenda
6. Emphasis on Investor Protection

1. Increased Reporting Framework

In the 2013 Act, there is significant focus on corporate reporting framework, both internal and external and a wide range of changes have been introduced keeping in mind objectives, such as the need for relevance and consistency in the financial information being reported, alignment with international practices, greater focus on internal controls, etc.Some of the requirements have also been introduced to address lacunae in some of the provisions under the 1956 Act and curb any related abuse.

The 2013 Act mandates preparation of consolidated financial statements for all companies that have one or more subsidiaries. These would be in addition to the separate financial statements and are required to be prepared in the same form and manner as the separate financial statements. For the purpose of this requirement, the word subsidiary would include associate companies and joint ventures.

As per internationally accepted practices, consolidated financial statements are generally considered as the primary financial statements and the only general purpose financial statements, as standalone financial statements do not present a true picture from an economic entity perspective. The requirement of consolidated

A financial statement is therefore an important step even though the primacy of standalone financial statements has been maintained.

2. Higher Auditor Accountability [section 139]

As per the 2013 Act, instead of the present provision of appointment from one AGM to the next, individual or a firm to be appointed as auditor for a five-year term. Change of auditors before the five year term would require special resolution after obtaining the previous approval of the Central Government. Further the auditor concerned would have to be given a reasonable opportunity of being heard however the appointment has to be ratified at every AGM. If the appointment is not ratified, it appears that the process for change of auditor would have to be followed.

Listed companies or companies belonging to such class of companies as may be prescribed cannot appoint or reappoint an audit firm (including an LLP) as auditor for more than two consecutive terms of five years each (in case of an individual there would be one term of five years).There is a cooling off period of five years for both individual auditors and audit firms. Audit firms having common partner or partners to the outgoing audit firm will also not be eligible for appointment till the cooling off period of the outgoing firm has expired. Companies need to be compliant with the provisions relating to rotation within three years from the date of the commencement of the Act. Central Government may, by rules, prescribe the manner of rotation. As per the draft rules, this requirement has been extended to all companies except small companies and one person companies.

3. Easier Restructuring/ Rationalizing Multilayered Structures [section 186]

A company cannot, unless otherwise prescribed, make investment through more than 2 layers of investment companies except to comply with law and in case of acquisition of a foreign company. Compliance with this requirement may involve significant restructuring in many cases. Government empowered to prescribe the maximum number of layers of subsidiaries that any class of holding companies can have. The objective seems to be to provide transparency about the real owners of the companies. However, this may impact many large Indian and foreign companies particularly companies operating in infrastructure sector in which land is held or separate funding of different projects is done through a chain of step down subsidiaries.

4. Wider Director and Management Responsibility

Maximum number of directors at 15 (12 at present). This number can be enhanced by special resolution without Central Government approval. At least one director should be a person who has stayed in India for a total period of not less than 182 days in the previous calendar year. Certain class of companies to have at least one women director. The draft rules state that every listed company & other public company having either paid up share capital of more than 100 cr or turnover of more than 300 crores to appoint a women director. For listed companies and other class of companies to be prescribed it would be mandatory to set up a Nomination and Remuneration Committee to recommend appointment and removal of directors/senior

management and remuneration policy and to evaluate performance of directors. An attempt to enhance objectivity in these matters through non-executive and independent directors.

Companies having more than 1000 shareholders, debenture holders, deposit-holders or other security holders at any time during the financial year to constitute a Stakeholders' Relationship Committee to resolve the grievances of security holders. An investor grievance redressal mechanism with a non-executive chairman would ensure protection of the interest of investors through timely intervention. Apart from listed companies, other classes of companies as may be prescribed to have Audit Committee having a minimum of three directors with independent directors forming a majority; majority of members including its chairperson to be persons with ability to read and understand the financial statements. The office of a director would become vacant if he remains absent for all meetings of the Board for a period of 12 months, even where the leave of absence has been obtained. This is likely to result in more active involvement of directors. The new changes are: At least 1/3 of the board of directors of the listed company shall be independent directors; Independent directors can serve 2 consecutive terms of five years each on the Board. Their liability shall be limited., Mandatory internal and secretarial auditing provisions., Mandatory rotation of auditors., Limitation of number of companies which can be audited by an auditor., Elaborate quorum requirements., Prohibition on insider trading and forward dealing by directors and key management persons., Uniform financial year from April to March for all companies., Higher disclosure requirements., Stringent accountability on directors, auditors and other professional associated with the company., Restriction on investment through more than two layers of investment companies., Mandatory disclosure of interest by directors., Streamlined procedure and disclosure in respect of related party transactions., Introduction of voting though electronic participation, meeting through video conferencing., Requirement that at least one director shall be stayed in India for a total period of not less than 182 days.

5. Inclusive CSR Agenda

The Ministry of Corporate Affairs (MCA) had introduced the Corporate Social Responsibility Voluntary Guidelines in 2009. These guidelines have now been incorporated within the 2013 Act and have obtained legal sanctity. The Companies Act, 2013 requires that every company with net worth of '500 crores or more, or turnover of '1,000 crores or more or a net profit of '5 crore or more during any financial year will constitute a CSR committee. The CSR committee will consist of three or more directors, out of which at least one director will be an independent director. The board's report will disclose the composition of this CSR committee. The CSR committee will:(a) Formulate and recommend to the board, a CSR policy, which will indicate the activities to be undertaken by the company (b) Recommend the amount of expenditure to be incurred on the activities referred to in the CSR policy (c) Monitor CSR policy from time to time. The board will ensure that company spends, in every financial year, at least 2% of its average net profits made during the three immediately preceding financial years in pursuance of CSR policy. For this purpose, the average net profit will be calculated in accordance with the section 198(net profit before tax). The company will give preference to local area and areas around where it operates, for spending the amount earmarked for CSR activities. The board will approve the CSR policy and disclose its contents in the board report and place it on the company's website. The committee shall formulate the policy, including activities specified in Schedule VII, which are as follows: Eradicating extreme hunger and poverty, Promotion of

education ,Promoting gender equality and empowering women ,Reducing child mortality and improving maternal health ,Combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases ,Ensuring environmental sustainability ,Employment enhancing vocational skills, Social business projects ,Contribution to the Prime Minister's National Relief Fund or any other fund set-up by the central government or the state governments for socio-economic development and relief, and funds for the welfare of the scheduled castes and Tribes, other backward classes, minorities and women and Such other matters as may be prescribed .

6. Emphasis on Investor Protection [section 188]

The Companies Act, 2013 has made significant amendments vis-à-vis related party transactions making this a significant focus area. The responsibilities are rather onerous with strict consequences in cases of non-compliance. Key highlights are as follows:

The transactions of a company with its related parties which are not in the ordinary course of business and which are not arm's length would require the consent of the Board of Directors of the Company. Related party transactions have been defined to include the following :Sale, purchase or supply of any goods or materials, Selling or otherwise disposing of, or buying, property of any kind, Leasing of property of any kind, Availing or rendering of any services, Appointment of any agents for purchase or sale of goods, materials,services or property, Related party's appointment to any office or place of profit in the company, its subsidiary company or associate company and Underwriting the subscription of any securities or derivatives of the company. The definition of 'related party' with respect to a company has been widely defined and includes: Holding Company, Subsidiary Company, Sister Subsidiary, Associate Company, Directors, Key Management Personnel (including relatives),Firms / companies where directors /relatives are interested and Senior management i.e. members of core management team one level below executive directors including functional heads.

Undoubtedly, "corporate regulation" is a complex matter. It has to be a right mix of self-regulation and Government regulation. It appears that the new Bill has tried to manage both the aspects. The hope is that the new contemporary and pragmatic legislation will bring radical changes to the way corporate India functions. It has all the right elements. Although it is more comprehensive and appears to be uncomplicated than its predecessor, it is still in its initial stage of implementation and will need many more clarifications and subsidiary rules from the law makers to make it fully operational. However, the process is still half done. The Bill only lays down the basic framework of the company law and leaves the procedure to be determined by the rules to be formed by the Central Government from time to time. The real challenge will be to formulate an efficient and transparent procedure which will run the Indian corporate juggernaut smoothly and curtail corporate scams. In this connection, all eyes will be on the Serious Fraud Investigation Office (SFIO), the agency mandated to investigate corporate scams, which has been armed with the authority to impose punitive measures and in specific instances, arrest persons found guilty of corporate crimes.

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